Digitisation

The revolution transforming Private Equity

pwc

Introduction

As a region, the Middle East has embraced the digital revolution. Now more than ever before, we are seeing an increased comfort in ‘going digital’ unsurprisingly given the region’s young demographics and good quality infrastructure. Certainly, at a consumer level there is a high level of technology adoption: Bahrain, Kuwait and the UAE are among the most penetrated countries in the world with a mobile subscriber rate of over 90%[1]. Although, with that said, most Middle Eastern companies are still in the process of adoption stage in comparison to the West when it comes to digitisation.

What do we mean by digitisation?

We mean transforming analogue and manual processes, functions and tasks into digital throughout a company. Digitisation encompasses digitising product and service offerings as well as expanding the business model and customer access by offering disruptive digital solutions.

At a corporate level, digital has disrupted almost every industry sector, and will continue to do so. As the digital landscape evolves, there is a pressing need for private equity (PE) houses in the Middle East to keep up with these rapid changes, or risk being left behind. The PE investment horizon means that the digital transformation of a portfolio company is being assessed and planned even before PE houses even think about investing in any new company.

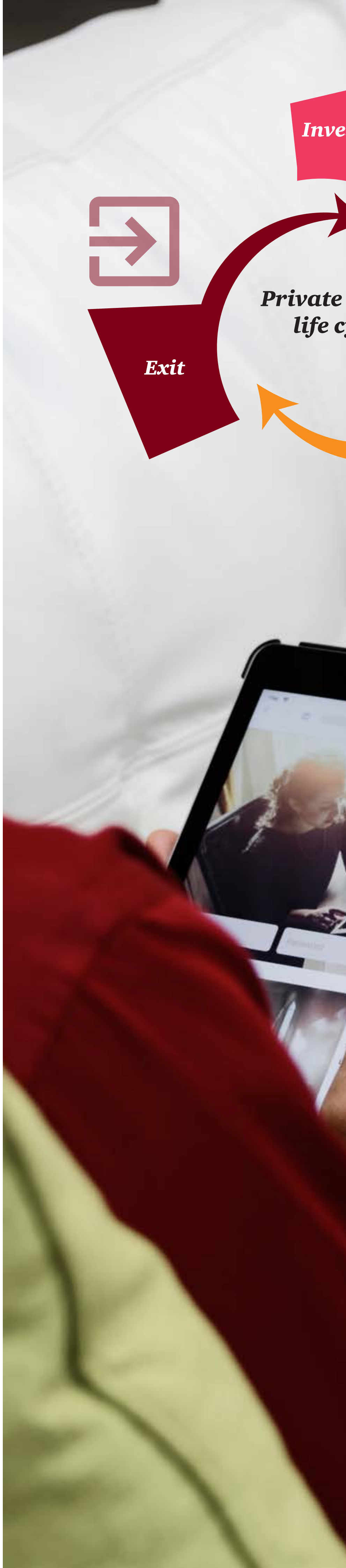
Digitising a company does not need to be expensive, and digital can create value throughout the PE holding period: new customers can be found online; costs can be optimised through more efficient purchasing and operational management; cash flow can be improved and the wealth of data now being generated by connected devices and customers can inform everything from product design to customer interaction and marketing.

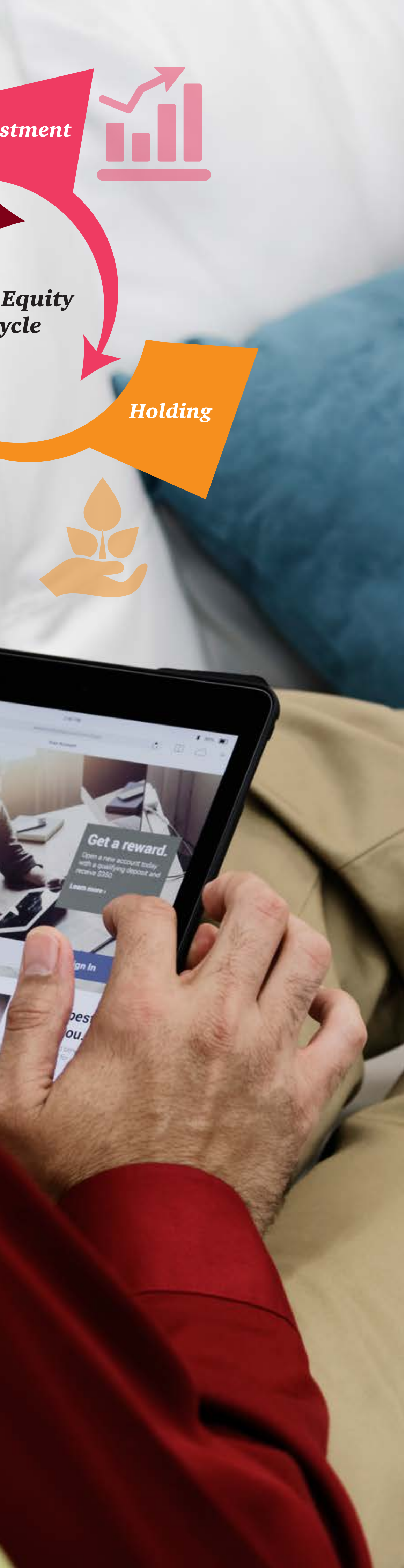
PwC Middle East surveyed a number of leading PE firms in the region to find out what digitisation means to them and how it’s impacting their investment decisions.

Our survey focuses on the PE life cycle from the time of investment, holding period right through to exit and highlights the maturity of digital developments facing the region.

> ***“Digitising a company doesn't have to be expensive and will create value throughout the PE holding period”***

[1] [https://www.gsma.com/mobileeconomy/mena/]





Private Equity life cycle:
Phase 1 - Investment

At the initial investment stage, PE houses usually focus on two main areas (plan and assess) when they are thinking about going digital:

1. Plan

PE houses identify and plan how the potential impact of digital will have on the companies they are investing in, whether this be the threat of disruptive competition or the opportunity for new sales and service provision.

2. Assess

PE houses assess the extent of digitisation within a company, and how digital can be used to optimise cost and/or revenues.

Such things can fundamentally change a company's business model, and therefore the digital investment of portfolio companies should be at the forefront of management and board thinking.

Our survey shows that PE houses believe that going digital is a necessity. It features heavily in the investment decision process and value creation plans of all the private equity firms we surveyed in the Middle East region. Notably, 80% of PE houses said that digitisation is critical for making their companies 'future ready'.

These findings are even stronger than in Europe, where digitisation is more advanced. A comparable PwC Private Equity & Digital Transformation survey[2], led by our European colleagues, found that less than two-thirds (62%) of private equity firms thought that digital could deliver 'sustainable value' for a company, although it was considered the single most important trend influencing investment decisions.

> ***"80% of PE houses believe that digitisation is critical for making their portfolio companies 'future ready'"***

[2] [https://www.pwc.nl/nl/assets/documents/pwc-private-equity-and-digitisation.pdf]

90% *of investors surveyed*

in the Middle East

are digitising at least one of their portfolio companies

75% of PE houses are now focused on the digital maturity of a company at due diligence stage of their acquisition

Digitally enhancing portfolio companies depend on the actions & attitudes of wider stakeholders, the board & management, and on how easy it is to change customers' mind set

Almost three quarters said that they are now focused on the level of maturity of a company's digitisation during the due diligence stage of an acquisition. When we marry this to the recent deal activity happening in the region, we are seeing industries such as Financial Services, Healthcare, Retail and Consumer as investable sectors all focused on enhancing their digital footprint.

The region is already being heavily disrupted by digital. Some examples include:

- ***Financial Services*** (Fintech)
- ***Retail*** (E-commerce)
- ***Healthcare*** (AI and Robotics)
- ***FMCG*** (Customer data capture)
- ***Manufacturing*** (B2B supply chain)

That said, for all of the recognition of digital's importance, PE companies are cautious about their initial investment decisions and they are unlikely to be early adopters of the latest technologies. Given capital constraints and holding periods (typically investors look to sell on assets after 3-5 years) PE houses will adopt a very pragmatic approach to digitisation.

PE houses will carefully consider the solutions to be rolled out, ensuring they have been tested before committing to them. The risk and costs of testing a very innovative solution will probably exceed the expected return in their typical time horizon. Digitisation is not something that can simply be imposed by PE investors. Rather, digitally enhancing portfolio companies depends on the actions and attitudes of wider stakeholders including the Board and Management, and on how easy it is to change customers' mind set.

Overall, our survey suggests that PE houses recognise that they are at a crossroads here. They must balance the risks of adopting new technology against the opportunities it offers and the danger of failing to build the exit equity story.

Private Equity life cycle:
Phase 2 - Holding

From our survey findings, it is clear that digitisation means different things to different PE houses. Some see it as an enabler to maximise revenues within a fairly short timeframe. Others see it as a way to improve management reporting, with better-quality data feeding better informed decision making. There is a general consensus over the need for better information systems including real time information.

Some 70% of companies say that digital can reduce operating expenses

79% believe production and procurement savings would be the most important impacts of digitisation on portfolio companies

There is also increasing awareness of how digital is disrupting the business model. For example, we are already seeing Procurement 4.0 and how digital innovation is disrupting the entire procurement value process[3]. The market is seeing some innovative examples of how digital is rapidly transforming supply chain and logistics, such as, efficient inventory management and transport tracking systems. Some 79% of our respondents in the Middle East say that such production and procurement savings are some of the most important impacts of digitisation on portfolio companies.

In fact there is no single right way to embrace digital or to adopt new technologies: the extent of digitising portfolios must be based on the current needs of the company and on global industry standards.

[3] [https://www.strategyand.pwc.com/media/file/Procurement-4.pdf]

Leveraging global expertise

PE firms need a strong management team on the ground who truly understand the specific companies' digital needs and the extent to which these technologies can be implemented. PE houses have also found ways to access global knowledge through experts and advisors. Hiring external expertise allows them to manage the skills gap in their own management teams and at Board level in the region. They consider the digital agenda to be a Board discussion topic and the focus should often be given to Board members who have lead such transformation projects either inside or outside of the region.

Private Equity life cycle:
Phase 3 - Exit

The digital revolution is further increasing the focus PE houses should have on the exit phase before they invest. They must ask questions about how the investment industry will be disrupted and what that will mean for the asset. Industries from retail to healthcare will be heavily impacted in the near future, so this needs to be a major consideration when looking to exit. That is all the more true for PE houses looking to sell assets to international buyers, who will expect global standards when it comes to the assets' digital offering and capabilities.

> ***"The digital revolution is forcing PE houses to focus on the exit phase before they invest"***

Using digital to increase sales and performance will be seen as central to maximising value by the time investors decide to exit. Therefore developing a robust digital strategy that compliments the exit process will be key. 95% all of our respondents think that digital is important to future exits from their portfolios, and to the returns on investments that can be realised.

> ***"Having a digital offering is even more important for B2B companies selling to other firms than the end consumer because it is harder to differentiate B2B firms from their rivals"***

E-commerce remains relatively underdeveloped in the Middle East and reportedly accounts for just 2% of retail sales[4] compared to over 17% in the UK[5]. With such high mobile penetration in the region, it is reasonable to expect there will be rapid catch-up growth in this sector.

[4] [https://www.pwc.com/m1/en/publications/total-retail.html]

[5] [http://www.retailresearch.org/onlineretailing.php]

All of this suggests that digital markets will grow very fast with mobile platforms becoming increasingly important in areas such as healthcare, where apps such as Babylon are even using artificial intelligence (AI) to answer users' medical queries. Our findings suggest that companies in the Middle East have been cautious over exploiting the potential of such new technology - none of our respondents have actually implemented things like AI robotic surgery, for example, although it is interesting to some investors. There was no mention of online monitoring of patients, which has been used successfully in countries such as India and China. More broadly, areas such as AI and smart manufacturing seem to be further down the agenda.

The Governments focus on digital

Digital transformation is high on the agenda for Governments across the region, with many national programmes launched to improve and develop the countries' digital infrastructure and economy. In the UAE, we have seen the Smart Dubai initiative launch in early 2017 which sets out for the UAE Government to be 100% paperless by 2021. Saudi Arabia views digitisation as a key enabler for its Vision 2030 transformation programme. Investors are recognising that, as the infrastructure develops and companies join consumers in a rapidly evolving digital landscape, it will become increasingly central to company performance. This should also support the digitisation efforts of the region.

Looking forward

When we compare the Middle East landscape to that of Europe or the West, it is clear that all regions are at different stages of digital adoption. Our survey shows that PE firms here in the Middle East have considered the extent to which they should increase their investment in digital beyond the traditional domains such as enterprise resource planning (ERP) systems.

The unique and vast opportunities that this presents in the region is exciting. The Middle East can tap into sector knowledge from across the globe, meaning PE firms can benefit from best practice and lessons learned from the West. Being part of a growing economy means that there are fewer technologies already in place and less need to upgrade legacy systems. Many companies are starting with a blank canvas.

The digital revolution has changed the way products and services are consumed. As the market continues to adapt to consumer demand, PE firms and portfolio companies must remain relevant by mirroring consumer behaviour.

Having a digital strategy is essential for 'future proofing' a company that wants to retain market share and stay ahead of the competition. Those who are nimble will reap the benefits of the value to be created through digitisation. This mindset must also be adopted by management teams who can no longer survive without integrating digital capabilities within their teams to complement their traditional skillsets.

> ***"A digital strategy is essential for 'future proofing' a company that wants to stay ahead of the competition"***

Complacency is no longer an option. When you prepare to exit, you must already be digital. The digital revolution is already having a profound impact on the PE ecosystem, and there is no choice now but to embrace it.

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